OSC

ONTARIO SECURITIES COMMISSION

Statement of Priorities 2006/2007

June 2006

INTRODUCTION

The *Securities Act* requires the Ontario Securities Commission (OSC) to deliver to the Minister and to publish in its Bulletin by June 30 of each year a statement by the Chair setting out the proposed priorities for the Commission for the current financial year. The OSC remains committed to delivering its regulatory services in a businesslike manner and to working closely with its colleagues within the Canadian Securities Administrators (CSA) and with market participants to ensure that the regulatory system remains relevant to the changing marketplace.

Our Vision

Canadian financial markets that are attractive to domestic and international investors, issuers and intermediaries because they are cost-efficient and have integrity.

Our Mandate

To provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets and confidence in their integrity.

Our Approach

- Proactive, innovative and cost-effective in carrying out our mandate
- Fair and rigorous in applying the rules to the marketplace
- Timely, flexible and measured in applying our regulatory powers to a rapidly changing marketplace

2007-01581/

MESSAGE FROM THE CHAIR

The Ontario Securities Commission's Statement of Priorities for the 2006/07 fiscal year articulates the commitment of the OSC to deliver fair, efficient and effective regulation of the capital markets in Ontario. Our Statement of Priorities sets out the organization's business strategy and goals, as required under the *Securities Act*.

David Wilson,
Chair, Ontario Securities Commission

This year, our overall goals are accompanied by specific initiatives introduced in order to achieve these objectives. The Statement of Priorities also identifies certain challenges facing regulators and market participants in today's constantly changing capital markets.

The OSC's five organizational goals encompass the following areas of securities regulation: enforcement, retail investors, regulatory harmonization, international regulatory cooperation and organizational accountability. These are the key priorities to carry out our dual mandate to provide protection to investors from unfair, improper or fraudulent practices and to foster fair and efficient capital markets as well as confidence in their integrity.

I hope you find our Statement of Priorities informative and helpful, and enjoy reading it in a more simplified format.

Yours very truly,

David Wilson

Chair

KEY CHALLENGES

The OSC faces numerous external and internal challenges as it strives to fulfill its mandate and to meet its objectives. These challenges emphasize the importance of fostering fair and efficient markets and confidence in their integrity, while maintaining a strong, visible and effective enforcement presence.

The investor community has grown significantly in recent years, as almost all adult Canadians are invested in the capital markets through direct retail investments or indirectly via mutual funds and pension plans. More and more investors are relying on the capital markets to grow their wealth. Moreover, in an aging society, Ontarians will come to rely more on the capital markets to preserve their assets and generate a steady income in retirement. To meet these demands from investors, the investment industry has created increasingly innovative, and sometimes more sophisticated, investment products, services, trading strategies and advice.

The expansion of the investor community, both institutional and retail, has shifted attitudes toward investment risk and illustrated the need for investor education because Canadians are taking more responsibility for their personal financial planning. For the OSC, part of our challenge is to continue to improve our understanding of the needs of investors. We must remain focused on compliance and disclosure and increase the vigilance of our enforcement activities to prevent, detect and deter harm to both investors and the overall markets. By doing so, we will foster confidence in investors that capital markets are fair and efficient.

Today's securities industry is a global marketplace and Canadian public companies compete with corporations around the world for cost-effective sources of capital. This competition is intense – an increasing number of Canadian corporations are seeking to raise capital from international sources and more foreign firms search for pools of capital within Canada. This competition has contributed to the emergence of new market structures, technological innovations in trading systems and the development of new investment products.

Securities regulators face the challenge of keeping pace with the level of innovation in the marketplace and balancing the costs of regulation. Our regulatory framework must contribute to global competitiveness and promote the resilience of our capital markets. Striking the right balance involves developing practical, accountable and transparent regulation and policies, while

carefully avoiding placing undue burdens on market participants. Pursuing flexibility and balance will allow our capital markets to foster new business growth in the private sector.

The OSC will cooperate with our provincial, territorial and international regulatory colleagues to foster a harmonized, streamlined and modernized regulatory framework. We will work with the Government of Ontario in supporting measures that are consistent with creating a common regulator, a common set of securities laws and a single fee structure for Canada. Furthermore, we support the introduction of enabling legislation to provide regulators with tools to create a more efficient and effective single window of access for market participants. Capital markets are an essential part of the engine for economic growth in Ontario, and we believe regulatory reform can benefit investors, business and the province as a whole.

In this context, we must ensure that the OSC conducts itself as an efficient, accountable and flexible organization as it serves issuers, investors and intermediaries. We will also continue to improve our service to our stakeholders, maintain excellent internal controls and promote high staff morale.

OUR GOALS

For Canadian financial markets to be attractive, they must be – and be seen to to be – fair and efficient for investors and other market participants. Given the trends and challenges outlined above, we need to find creative and innovative solutions to new issues, be willing to re-evaluate existing practices in light of changing circumstances and make decisions at the pace at which our markets are changing. We need to operate in a transparent and accountable manner and to enforce clear rules in a consistent and visible manner.

Our Statement of Priorities for 2006/07 sets out our key priorities to fulfill our mandate, the major projects we will undertake, and the resources required to complete this work. We have identified five key organizational goals for the coming year, and outlined the strategies related to achieving the goals. Detailed initiatives set out the actions that we will undertake towards achieving the various outcomes. We will also continue to work on a range of smaller projects, as well as our ongoing operational activities to advance our regulatory agenda.

Goal 1: Provide fair, vigorous and timely enforcement

In our enforcement activities, we will treat all market participants fairly and with integrity, employing consistency in our approach and sanctions. A vigorous and timely enforcement presence is critical to protect investors, to deter undesirable behaviour and, when necessary, to remove participants from our capital markets who do not comply with securities laws. We will:

1. Improve the effectiveness of our enforcement work through reduced timelines for completing investigations and bringing regulatory proceedings forward;
2. Increase our transparency through more timely and effective communications of enforcement actions where warranted;
3. Focus additional enforcement and compliance resources and optimize our internal coordination among OSC branches to proactively identify and reduce illegal market conduct and prevent harm to investors;
4. Contribute to effective enforcement through increased coordination with other enforcement agencies, including participation with the RCMP on Integrated Market Enforcement Teams (IMETs), which are designed to respond to major capital market fraud and market-related crimes. We will continue to strengthen our relationships with self-regulatory organizations (SROs) and international regulators, particularly the U.S. Securities and Exchange Commission. In addition, we will seek increased co-operation with the criminal law authorities, including the provincial Office of the Attorney General, to identify more cases for prosecution in court; and
5. Develop and implement technological tools to improve the efficiency and effectiveness of our enforcement effort, such as enhancing our ability to access data from dealers and marketplaces to improve the quality and efficiency of the regulatory surveillance and monitoring of trading activity and market data.

Specifically, we plan to:

1. Take steps toward developing and evaluating Electronic Audit Trail requirements and processes (TREATS). We will issue a Request for Proposals (RFP) to create a facility to transmit and track regulators' data requests from the dealers. Responses will be reviewed and, if a decision to proceed is made, we will begin developing the facility for testing;
2. Take all necessary steps to ensure that our enforcement efforts are – and are seen to be – as robust and effective as possible. During 2006/07, we will conduct a thorough review focused on enhancing our enforcement capabilities, strategies and initiatives to ensure that:
   - We are strategically selecting cases for investigation and prosecution;
   - Enforcement activities and processes are efficient and fair;
   - An effective and appropriate process exists for identifying and moving to enforcement cases from all the OSC's compliance functions; and
   - We have skilled staff in all areas of enforcement.
3. Increase public awareness of fraud prevention and detection through community outreach partnerships, proactive media campaigns and the Investor Education Fund website. We will:
   - Actively communicate through consumer shows and events to achieve the following targets:
     - Increase potential and actual audience and distribution numbers by 30%;
     - Increase subsequent calls/website visits related to relevant key messages (including fraud prevention) by 25%; and
     - Audience research will suggest that audience members retained 70% of relevant key messages after the event, as measured by follow-up phone calls/e-mails.
   - Increase readership/viewership/listenership impressions for proactive unpaid media hits that showcase investor communications messaging (Investor Alerts) by 10% overall, with an equivalent ad value of at least $250,000.

Goal 2: Take actions to better understand and address the needs of the retail investor

We will work to improve our understanding of the concerns and priorities of retail investors and be more responsive to their needs. We will:

1. Engage retail investors in the regulatory process by seeking input through opportunities for consultation and education;
2. Continue to provide appropriate tools, educational materials and information to retail investors to allow them to make informed decisions and become partners in their protection against unfair, improper or fraudulent practices. For example, we will assess the options to increase the public awareness of relevant OSC programs and services, using such means as the Investor Education Fund and targeted media and outreach campaigns;
3. Work with other regulators and SROs to improve the interface between investors and financial services professionals, including the use of clear, concise and effective disclosure. We will actively encourage the securities industry to continue to raise the standards and transparency of conduct, service and advice in its interactions with retail investors;
4. Increase the focus of our regulatory efforts to assess the best means to provide protection to investors against unsuitable investment products and advice; and
5. Work with the Government to improve investor access to timely and affordable means of restitution, including enhancing investor awareness of, and access to, existing mechanisms for resolution of client complaints and restitution such as that offered by the Ombudsman for Banking Services and Investments (OBSI).

Specifically, we plan to:

1. Increase consultation with retail investors through the new Investor Advisory Committee (IAC) to improve our understanding of the needs and concerns of investors. A year-end survey of the Chair and members of the IAC will:
   - Confirm that our support and assistance to the IAC was appropriate and effective; and
   - Collect the views of the Chair and IAC members on opportunities to improve the IAC's operations and recommendations for the future, so that we may consider possible responses to their recommendations;

2. Contribute to helping investors improve their understanding of the complaint-handling process within the securities regulatory regime. We will take actions to:

   - Ensure timely responsiveness to written complaints, as measured through turnaround times of our Inquiries & Contact Centre. Our target will be to respond to 80% of these complaints within 20 business days, with an overall average of less than 45 days; and
   - Revise the OSC's online and print materials about the complaint process, including dealing with SROs and the banking services ombudsman, to enhance readability and usability for retail investors, as measured through focus group review by the IAC;

3. Modernize the scholarship plan regime, including improved point-of-sale disclosure. Our key deliverable will be to publish for first comment a national instrument (NI 46-102) that will require meaningful and consistent disclosure of scholarship plans for investors and fair presentation of performance information and will update investment restrictions and practices;

4. Modernize the point-of-sale regime for mutual funds and segregated funds. Our key deliverable will be to publish for first comment a national instrument that will require clearer and more understandable product and sales fee disclosure for investors in mutual funds, introduce more effective "cooling off" rights and result in the improved regulatory harmonization of the point-of-sale regimes for mutual funds and segregated funds; and

5. Implement the appropriate regulatory response to the Mutual Fund Probe to increase investor confidence in the investment fund industry. Our key deliverable will be to publish for first comment a national instrument (NI 81-108) that will require investment fund managers to implement an appropriate compliance program and provide guidance on fair value pricing.

Goal 3: Promote a harmonized, simplified and strengthened securities regulatory framework for Canada

We will cooperate with the Government of Ontario, other securities regulators and market participants to strengthen the Canadian securities regulatory system and:

1. Work to further harmonize, streamline and modernize securities laws and eliminate obsolete and redundant requirements to ease the regulatory burden on market participants; and
2. Pursue measures to improve the efficiency of Canadian capital markets by taking steps to strengthen the securities clearing and settlement system.

Specifically we plan to:

1. Work toward harmonizing and rationalizing our local, multilateral and national prospectus requirements by publishing a national instrument (NI 41-101) for comment which harmonizes and rationalizes local, multilateral and national long-form prospectus rules, forms, policies and notices;
2. Enhance investor confidence in hedge funds and similar products. We will work with the CSA to identify any areas of concern arising from a review of hedge funds and similar products and propose regulatory responses to those concerns;
3. Introduce a fund governance regime for investment funds. During 2006/07 we will publish a final version of National Instrument 81-107 that will implement a requirement for all investment funds to have an independent review committee oversee conflict-of-interest matters;
4. Work toward amending National Policy 41-201 *Income Trusts and Other Indirect Offerings* to address emerging issues that have arisen since implementation of the policy in 2004, including those related to distributable cash and other financial disclosure;
5. Reassess executive compensation disclosure requirements. Our key action in this area will be to analyze the issues that have arisen around executive compensation disclosure and publish a proposed regulatory response for comment; and
6. Harmonize the registration regime as part of the CSA Registration Reform Project. During 2006/07 we will draft new legislation and rules that will reduce regulatory costs for registrants by streamlining and harmonizing requirements.

Goal 4: Work to achieve appropriate regulatory integration of North American and global capital markets

The securities industry operates within a global marketplace where capital moves rapidly across international borders. We will work to enhance the global competitiveness of our capital markets as well as foster cooperative relationships with other securities regulators and standards setters. We will:

1. Play an active role in working with international regulatory and standard-setting organizations (e.g., International Organization of Securities Commissions [IOSCO], Council of Securities Regulators of the Americas, North American Securities Administrators Association, International Accounting Standards Board);
2. Foster inter-jurisdictional co-operation to reduce impediments to the coordination of investigative efforts and enforcement support, and coordination of legislative tools for enforcement;
3. Strive to minimize the differences in regulatory practices by ensuring that our policies are integrated with international regulatory standards, where appropriate, for Canadian market participants; and
4. Improve the relevance and reliability of financial information available to investors by promoting convergence of high quality financial reporting and auditing standards and the related supporting infrastructure, including mechanisms for independent oversight of audit firms.

Specifically, we plan to:

1. Support IOSCO initiatives on regulatory integration. We will take the following actions toward achieving this outcome:
   - Participate in IOSCO initiatives relating to the development of international standards and guidance on critical investment fund issues, such as fund governance, hedge funds and market timing and late trading;
   - Develop an approach to regulate an intermediary's obligation to properly manage information during an offering of securities;
   - Use communication vehicles such as executive speeches and OSC publications to support and promote appropriate initiatives on regulatory integration; and
2. Issue a final rule that establishes appropriate public reporting requirements relating to internal controls over financial reporting. The final rule will promote improved internal controls and higher quality, more reliable financial statements.

Goal 5: Support and promote a more flexible, efficient and accountable organization

We expect OSC Commissioners and employees to maintain the highest standards of conduct and personal integrity and to deal openly and fairly with all of our stakeholders. We need to constantly advance our business competence and effectiveness. We will:

1. Continuously monitor and improve the efficiency and effectiveness of our operations;
2. Display responsiveness and flexibility as an organization and treat all stakeholders with respect and fairness;
3. Work to attract, develop and motivate skilled and enthusiastic staff; and
4. Use information technology effectively to support our operations and optimize our electronic interface with our stakeholders.

Specifically, we plan to:

1. Undertake and report on surveys to obtain feedback on our performance. We will complete and assess our biennial OSC Stakeholder Satisfaction Survey of the OSC's core constituencies – reporting issuers, registrants, Inquiries Line Users and the general public. We will identify opportunities for improvement in areas where stakeholders do not express positive customer service ratings of the OSC;
2. As part of a multi-year knowledge management project, complete an organization-wide information audit to assess how the OSC creates, stores and accesses information in its operations. During 2006/07 we will complete an information audit and develop a plan based on the results of the audit; and
3. Develop and implement a human resources succession plan. We undertake to develop and implement a succession plan that will be easy to maintain and will address talent management and workflow continuity at the OSC. The process will ensure staff is developed and ready to replace key senior and executive management roles as required.

2006/2007 FINANCIAL OUTLOOK

Our goal is to ensure that fees paid by issuers and registrants reflect the costs of regulating each group. Surpluses have been generated since the fee schedule was introduced in March 2003. In March 2005, $14.9 million of this surplus was refunded to market participants.

Our 2006/2007 budget reflects our plan to return surplus funds earned during the past three years to our stakeholders by way of reduced fees. As a result, we are projecting a deficit of $12.2 million in 2007.

2007 Budget versus 2006 Actual

(Thousands)	2006 Actual	2007 Budget	Change	% Change
Revenues	$ 83,050	$ 60,016	$ (23,034)	– 27.7%
Expenses				
OSC Operations	65,752	70,275	4,523	6.9%
SEDI Modernization	71	1,893	1,822	2566.2%
Excess of Revenue	$ 17,227	$ (12,152)	$ (29,379)	
Capital Expenditures	$ 2,439	$ 1,284	$ (1,155)	– 47.4%

In 2005/2006, $83.0 million was earned in revenue. The OSC remains committed to ensuring that fees paid by issuers and registrants reflect the projected costs to regulate each group. Our new fee schedule became effective April 1, 2006. In setting these new activity fees we reviewed each service activity and its related cost. Participation fees were set at levels to generate a cumulative deficit equal to the forecast surplus collected from market participants as at March 31, 2006.

The chart below sets out the three-year projections that were used in developing the new fees. The forecast reflected management's best estimates at the time and is subject to material change.

(Thousands)	2006/2007	2007/2008	2008/2009
Opening Surplus*	$ 39,500	$ 27,500	$ 14,100
SEDI Modernization Commitment	1,900	–	–
	$ 41,400	$ 27,500	$ 14,100
Projected Revenues	58,300	60,000	63,000
Projected Expenses	(70,300)	(73,400)	(77,000)
Projected SEDI Modernization Costs	(1,900)	–	–
Projected Surplus	$ 27,500	$ 14,100	$ 100

* As projected at January 2006

The budget does not anticipate a material change in the level of market activity. Although our fee structure is designed to reduce the potential for significant fluctuations in revenues arising from market volatility, the potential for material market fluctuations due to world events is an ongoing source of risk that could have a negative impact on OSC revenues. OSC revenues are expected to be $60.0 million or 27.7% lower in 2006/2007. The revised fee schedule will affect stakeholders differently in order to better reflect the services they receive and the benefits they derive from participating in Ontario's capital markets.

Total participation fees paid by issuers are forecast to decline by 39.3%. Total participation fees paid by registrants are forecast to rise by 5.1%. Total activity fees are projected to decline by 10.9%. Late fees are forecast to fall by 32.8%. Investment income is forecast to fall by $200K due to expected lower cash balances.

OSC operating expenses are projected to increase by $4.5 million or 6.9% to $70.3 million. Salaries and benefits costs are projected to rise 5.5% to $51.6 million (2005/2006 – $48.8 million) accounting for more than 60% of the total budget increase. The increase reflects a decision to increase approved staffing by 3% from 412 to 424. The areas with the largest increases are compliance and enforcement. The rest of the increase is generated by annual performance related changes to salaries of current staff, additional bonus requirements arising from staff growth and the annualized impacts of various in-year staff changes and vacancies.

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As the regulatory body responsible for overseeing the capital markets in Ontario, the Ontario Securities Commission administers and enforces the provincial *Securities Act*, the provincial *Commodity Futures Act* and administers certain provisions of the provincial *Business Corporations Act*. The OSC is a self-funded Crown Corporation accountable to the Ontario Legislature through the Minister responsible for securities regulation.